IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

KIRTLEY THORNTON, FRANK MEYER and DONALD HORWITZ,	:	
Plaintiffs,	:	
v.	:	**C.A. No. 962-VCN**
BERNARD TECHNOLOGIES, INC., SUMNER BARENBERG, PETER GRAY, AL ZEIEN, DAVID RANKIN, and CAROL GOLDBERG,	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: October 15, 2008
Date Decided: February 20, 2009

Kirtley E. Thornton, Donald Horwitz, and Frank Meyer, Plaintiffs, *pro se*.

James E. Huggett, Esquire of Margolis Edelstein, Wilmington, Delaware, and Jordan D. Hershman, Esquire, Andrew J. Gallo, Esquire, and Josephine Deang, Esquire of Bingham McCutchen LLP, Boston, Massachusetts, Attorneys for Defendant Carol Goldberg.

Denise S. Kraft, Esquire of Edwards Angell Palmer & Dodge LLP, Wilmington, Delaware, Attorney for Defendant Al Zeien.

NOBLE, Vice Chancellor

I. BACKGROUND[1]

This is a case about the unhappy demise of a Delaware corporation and the director disagreement that has out-lived it. All three Plaintiffs, Dr. Kirtley E. Thornton, Donald Horwitz, and Frank Meyer (collectively, the "Plaintiffs"), are former directors of Bernard Technologies, Inc. ("Bernard" or the "Company") and are holders of preferred stock in the Company.[2] The Defendants are the Company and five former directors: Sumner Barenberg ("Barenberg"), Peter Gray, Al Zeien, David Rankin, and Carol Goldberg.

Since its founding in 1994, the Company has never earned a profit.[3] The specific twists and turns along the road to insolvency need no repeating because Bernard has now reached its final resting place, a Chapter 7 liquidation proceeding in the United States Bankruptcy Court for the District of Delaware.[4]

Now that the Company's viability has ended and the Plaintiffs' shares have "little or no value," they brought this action, immediately following the filing of the bankruptcy petition, seeking accountability, i.e. monetary liability, from those

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[1] For purposes of a motion to dismiss, the well-pleaded factual allegations of the complaint are taken as true. *In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319, 326 (Del. 1993).

[2] Plaintiff Thornton owns 65,000 shares of Series A preferred stock, 49,626 shares of Series B preferred stock, and 31,112 shares of Series C preferred stock. Plaintiff Horwitz, along with his wife, owns 114,000 shares of common stock, 15,337 shares of Series C preferred stock, and 2,717 shares of Series D preferred stock. Plaintiff Meyer owns 50,000 shares of common stock and 100,000 shares of Series A preferred stock. Compl. ¶ 3.

[3] *Id.* ¶ 13.

[4] The bankruptcy proceeding was filed on December 26, 2004, eight days before this action was filed. Defs. Goldberg and Zeien's Reply Mem. in Supp. of Mot. to Dismiss at Ex. 1.

responsible for the loss of their investment.[5] The Plaintiffs make clear in the Complaint their view that the Defendants, particularly Barenberg, are responsible for Bernard's demise. The Complaint is presented *pro se*, with Dr. Thornton apparently taking the lead for all three plaintiffs.

The precise nature of the allegations made by the Plaintiffs is less than clear. While it is obvious from the Complaint that the Plaintiffs attribute Bernard's failure to the Defendants, and seek compensation as a result, it is not readily apparent what legal arguments and factual allegations they present as a basis for such liability. The Court will characterize the claims as best it can. Because this is a *pro se* pleading, it may be judged by a "less stringent standard" than one filed by an attorney.[6] However, proceeding *pro se* will not relieve the Plaintiffs of their responsibility to present and support cogent arguments warranting the relief sought.

The Plaintiffs' allegations may be divided into three separate categories. First, the Plaintiffs complain of a series of Management decisions (the

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[5] Compl. ¶ 7.

[6] *Johnson v. State*, 442 A.2d 1362 (Del. 1982) (citing *Bounds v. Smith*, 430 U.S. 817, 826, (1977)). A review of the Plaintiffs' pleadings suggests the benefit of professional guidance. The Court does not consider whether that would justify abandoning the "less stringent" standard routinely applied to a review of *pro se* pleadings or whether the source of that professional guidance has her own problems. *See Delso v. Trs. for Ret. Plan for Hourly Employees of Merck & Co.*, 2007 WL 76634, at *12-14 (D.N.J. Mar. 6, 2007) (ghostwriting of *pro se* pleadings is an ethical violation). Similarly, the Court does not address "adequacy of representation" issues.

"Management" claims) by the Defendant Directors. Those are as follows: (a) the failure to hold and attend board meetings as needed and when appropriate; (b) failure to require the Company's management to provide the board of directors with financial statements for the period of January 1, 2004 through October 31, 2004; (c) the holding board meetings by telephonic conference call rather than in person, "resulting in little or no written materials given to the board"; (d) refusing the requests of Plaintiffs Thornton and Horwitz, while they were directors, to convene board meetings and access financial statements and other information; (e) rejecting three proposals made by Plaintiffs Thornton and Horwitz;[7] (f) "sabotaging" the Miroflex relationship and causing the breach of the Microflex agreements;[8] and (g) "preventing the Class A and B members of the Board" from fulfilling their duties through the creation of two committees (an Executive Committee and a Legal Committee) that did not include them.[9]

Next, the Plaintiffs complain of behavior resulting in unnecessary, and self-interested, expenditures by the Company (the "Waste" claims), authorized by the Defendant directors. These claims allege that (a) without approval of a

[7] The Complaint alleges that these three proposals were considered by the board and rejected by majority vote. Compl. ¶ 1(g)(1)-(3). Given this fact, the Court is uncertain how this amounts to something other than proper board action.

[8] Microflex had an exclusive licensing agreement with the Company to promote its product. *Id.* ¶¶ 19-20.

[9] *Id.* ¶ 1(h)(iv). It is not clear who these Class A and B members are. The Court assumes they are the Plaintiffs. The Plaintiffs do not allege facts that support any finding other than a proper committee delegation pursuant to 8 *Del. C.* § 141(c)(2).

disinterested board of directors, options to purchase 200,000 shares of common stock at fifteen cents per share were issued to the Defendant Directors; (b) Director and Chief Executive Officer Barenberg was retained and paid compensation and benefits which were "excessive and not justified" because Barenberg was "grossly incompetent or was blatantly deceitful, or both"; and (c) directors proposed that the Company sell to Barenberg its wholly-owned Singapore subsidiary at the price of $1 per share.[10]

Finally, the Plaintiffs complain of "false and misleading" communications (the "Disclosure" claims) by the Defendant Directors. These claims allege that (a) a "false and misleading unaudited balance sheet" was issued to the Company's stockholders in June of 2004; (b) a false and misleading Proxy Statement was issued which "falsely stated the number and price of stock options granted to" the Defendant Directors; and (c) that Barenberg concealed from the Board his actions with CV Holdings, which seem to be Barenberg's decision to stop making payments on a promissory note to CV Holdings, the result of which was an acceleration of payments under the note.

[10] There is no allegation that this sale was consummated, and the Complaint states that a scheduled vote on the matter was not held. Compl. ¶¶ 1(h)(vii), 39-41.

The Plaintiffs acknowledge that they bring both direct and derivative claims. They seek class certification for any direct claims against the Defendant Directors.[11] Two of the Defendants have moved to dismiss the Complaint.[12]

II. ANALYSIS

A. *Claim Against Bernard*

By virtue of Section 362 of the Bankruptcy Act any actions against Bernard are automatically stayed as of the date of filing.[13] Because this action was commenced after the filing in Bankruptcy Court, any claims asserted by Plaintiffs against Bernard directly are void *ab initio* and are hereby dismissed.[14]

The Court now turns to the remaining claims as asserted against the Defendants individually.

B. *The Motion to Dismiss Standards*

The standard for dismissal of direct claims pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted is well established. The motion will be granted if it appears with reasonable certainty that

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[11] The Complaint was originally framed as a request for the appointment of receiver for Bernard, pursuant to 8 *Del. C.* § 291. The Plaintiffs now concede that the Bankruptcy filing moots this request. Pls.' Resp. to Defs.' Mot. to Dismiss at 3.

[12] Only two defendants, Carol Goldberg and Al Zeien, have pursued this motion to dismiss. The Court finds their arguments equally applicable to all Defendants and will rule on this motion as if pursued by all defendants.

[13] 11 U.S.C. § 362(a)(1).

[14] *Rittenhouse Assocs., Inc. v. Frederic A. Potts & Co., Inc.*, 1983 WL 103269, at * 3 (Del. Ch. Aug. 1, 1983). It is difficult to identify exactly what relief the Plaintiffs seek against Bernard. It may be that Bernard is only a nominal defendant.

the Plaintiffs could not prevail on any set of facts that can be inferred from the pleading.[15] The Court is required to assume the truthfulness of all well-pleaded allegations of fact in the complaint, and all inferences that can reasonably be drawn in favor of the non-moving party are accepted.[16] However, neither inferences nor conclusions of fact unsupported by allegations of specific facts are accepted as true.[17] That is, a trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences.[18] As to the allegations supporting the derivative claims, the facts must be pled with particularity.[19]

C. *Are the Claims Against the Director Defendants Direct or Derivative?*

The initial question is whether Plaintiffs' claims are direct or derivative in nature. The Court makes this determination from the facts alleged in the Complaint.[20] In assessing whether a claim is direct or derivative, the Court must ascertain (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually).[21]

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[15] *Kohls v. Kenetech Corp.*, 791 A.2d 763, 767 (Del. Ch. 2000).
[16] *Gantler v. Stephens*, 2009 WL 188828, at *5 (Del. Jan. 27, 2009).
[17] *Id.*
[18] *In re Lukens Inc. S'holder Litig.*, 757 A.2d 720, 727 (Del. Ch. 1999).
[19] *Louden v. Archer-Daniels-Midland Co.*, 720 A.2d 135, 141 (Del. 1997).
[20] *See Dieterich v. Harrer*, 857 A.2d 1017, 1025-26 (Del. Ch. 2004).
[21] *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).

Plaintiffs' Management claims are derivative in nature.[22] When *Tooley* has been applied to situations similar to those presented by the Plaintiffs, comparable management claims have been found to be derivative instead of direct in nature.[23] Here, the Plaintiffs complain of quintessential director mismanagement and any recovery would be for the benefit of the corporate entity, and the Court finds these claims to be derivative.

In that same vein, the Waste claims are derivative as well. "[A]ctions seeking recovery for alleged acts of waste . . . historically have been regarded as derivative in nature, since such claims 'do not affect contractual rights of stockholders associated with the ownership of common stock.'"[24] Again, our case law finds allegations of waste and self-dealing transactions generally to be derivative instead of direct.[25] When a director engages in self-dealing or commits waste, he takes from the corporate treasury and any recovery would flow directly back into the corporate treasury. Any benefit to the stockholders would be limited

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[22] *See,* 2 EDWARD P. WELCH, ANDREW J. TUREZYN, AND ROBERT S. SAUNDERS, FOLK ON THE DELAWARE GENERAL CORPORATION LAW §327.2.1.2 (5th ed. 2008) ("Allegations of mismanagement on the part of directors generally have been held to state derivative claims.").

[23] *See, e.g.*, *Albert v. Alex. Brown Mgmt. Servs.*, 2005 WL 2130607, at *13 (Del. Ch. Aug. 26, 2005) (claims for gross negligence, and failure to provide competent and active management are "clearly derivative").

[24] DONALD J. WOLFE, JR. AND MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY §9.02[a], at 9-7 (2008) (quoting *Kramer v. Western Pacific Indus., Inc.*, 546 A.2d 348, 353 (Del. 1988)).

[25] *See, e.g.*, *Sample v. Mongan*, 914 A.2d 647, 660 (Del. Ch. 2007) (waste claim derivative).

to the indirect effect on their proportional ownership or share of the venture. This is a classic derivative formulation.

The Disclosure claims, at least on their face, however, are direct in nature.[26] "[W]here it is claimed that a duty of disclosure violation impaired the stockholders' right to cast an informed vote, that claim is direct."[27] Here, the Plaintiffs plead exactly that. They claim that the failure to disclose accurate balance sheets and information related to stock option issuance prevented them from making an informed decision when electing the Defendants to their positions on the Bernard Board of Directors. As a result, it is alleged the Company was mismanaged and Bernard descended into insolvency.[28] The Disclosure claims (or, at least a portion of them) are direct in nature.

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[26] *Dieterich*, 857 A.2d at 1029-30 (holding that disclosure allegations in proxy materials were direct claims, as they are based in rights secured to stockholders by various statutes); *Alex. Brown Mgmt. Servs.*, 2005 WL 2130607, at *13 (holding that a well-pleaded disclosure claim is a direct claim under *Tooley*); *In re Tyson Foods, Inc.*, 919 A.2d 563, 601 (Del. Ch. 2007) ("Where a shareholder has been denied one of the most critical rights he or she possesses-the right to a fully informed vote-the harm suffered is almost always an individual, not corporate, harm.").

[27] *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 772 (Del. 2006) (citing *In re Tri-Star Pictures, Inc.*, 634 A.2d at 330 n.12, 332)).

[28] It is possible for a claim to be both derivative and direct. *See Gentile v. Rossette*, 906 A.2d 91, 99-100 (Del. 2006). To the extent that the Plaintiffs complain about the alleged impact on their ability to exercise their shareholder voting rights knowledgably, they present a direct claim. When, however, they assert that bad things happened to Bernard (i.e., financial disaster) because they were induced into voting for allegedly inept directors, the Plaintiffs have done nothing more than painted derivative claims with a disclosure coating. To the extent that the Plaintiffs seek to recover for losses suffered by Bernard, those claims are derivative in nature because any recovery would benefit the entity as a whole.

D. *The Derivative Claims*

The derivative claims, upon the commencement of the bankruptcy proceeding, became the property of the bankruptcy estate and subject to the control of the Bankruptcy Court.

> Where a corporation has suffered an injury from actionable wrongs committed by its officers and directors, the remedy under a state's incorporation laws is a suit on behalf of the corporation. Such a suit may be brought by the corporation, or, in some circumstances, can be brought by the shareholders or creditors on its behalf. Regardless of who initiates the suit, the recovery goes to the corporation. When the action is brought on behalf of the corporation, it is referred to as a derivative action. Upon the filing of a bankruptcy petition, however, any claims for injury to the debtor from actionable wrongs committed by the debtor's officers and director become property of the estate under 11 U.S.C. § 541 and *the right to bring a derivative action asserting such claims vests exclusively to the trustee*.[29]

Thus, the Plaintiffs' derivative claims are the property of the bankruptcy trustee and subject to the control of the Bankruptcy Court. Those claims must be dismissed unless the Plaintiffs are able to demonstrate some authority to proceed in the trustee's stead.

Plaintiffs claim such authority by virtue of an email from the Chapter 7 bankruptcy trustee's attorney. That email reads:

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[29] *In re RNI Wind Down Corp.*, 348 B.R. 286, 292 (Bankr. D. Del. 2006) (emphasis added) (citing *Mitchell Excavators Inc. v. Mitchell*, 734 F.2d 129, 131 (2d Cir.1984) and *Skolnick v. Atlantic Gulf Cmtys. Corp*. (*In re Gen. Development Corp*.), 179 B.R. 335, 338 (S.D. Fla. 1995)). *See Cirka v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2004 WL 1813283, at *4 (Del. Ch. Aug. 6, 2004); *Delgado Oil Co., Inc. v. Torres*, 785 F.2d 857, 860-61 n.11 (10th Cir. 1986) (a shareholder's derivative action is property of the estate upon the filing of a petition in bankruptcy). *See also* 11 U.S.C. § 554(a).

> Dr. Thornton: As you know, I represent George L. Miller, the chapter 7 bankruptcy trustee for Bernard Technologies, Inc. (the "Company"). The filing of the bankruptcy acted as a stay of any civil litigation against the Company, including the below referenced suit. While we do not consent to the litigation proceeding against the Company, we have no objection to the litigation proceeding against any of the other parties. If you require any further clarification, please contact me.[30]

In order to proceed with their derivative claims, the Plaintiffs must be able to show: (1) that the bankruptcy trustee has affirmatively assigned or abandoned the claims to the Plaintiffs and (2) the Bankruptcy Court approved of Plaintiffs' prosecution of the claims in this Court.[31] The email from the bankruptcy trustee's attorney does not fairly demonstrate that the trustee assigned or abandoned the claims to the Plaintiffs, but, even if it could be read in that fashion, the Plaintiffs' claims fail because they have not secured the approval or authorization of the

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[30] Pls.' Resp. to Defs.' Mot. to Dismiss at Ex. B. Dr. Thornton had requested permission to proceed by the following email to the trustee's counsel:

> Re: Thornton, Horwitz, Myers v. Barenberg, Rankin, Goldberg, Gray, Zeien C.A. No. 962-N
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> Please be advised that the above case is not a lawsuit against Bernard Technologies, the corporation. We are suing only the board members listed above and have no interest in pursuing the assets of the company. Please forward your response email indicating your position in this matter so that we can provide your position to [the Court] in tomorrow's hearing.

Id. This email states that the Plaintiffs are not "pursuing the assets of the company," but, in pursuing the derivative claims, that is exactly what they are doing. Thus, Dr. Thornton's email, unfortunately, is misleading, even though it likely was not intentionally so.

[31] *See, e.g.*, *In re Haupt & Co.*, 274 F. Supp. 1007, 1012 (S.D.N.Y 1967); *see also Kemper v. Am. Broad. Co. Cos., Inc.*, 365 F. Supp. 1272, 1274 (S.D. Ohio 1973) ("where a receiver or trustee has been appointed, as here, the trustee is an indispensable party to a shareholder's derivative suit, and the shareholder must therefore make demand on the receiver or trustee and also obtain the consent and authorization of the bankruptcy or receivership court to bring suit. . . . Failure to do so warrants dismissal of the action." (citations omitted)).

Bankruptcy Court. Without that approval, the derivative claims may not go forward in this venue.

Accordingly, the Plaintiffs' derivative claims are dismissed.

E. *The Disclosure Claims*

Plaintiffs' disclosure claims seek both injunctive relief and money damages. For non-monetary relief, the Plaintiffs seek an order requiring the Company to issue a corrected financial statement for 2002-03, a corrected profit and loss statement for the year 2004, and to hold an election for a new board of directors.[32] Plaintiffs lack standing to seek this injunctive relief, and such claims must be dismissed.

Standing refers to a plaintiff's right to invoke the jurisdiction of a Court to redress his grievance. Standing is a threshold question, and, because standing is jurisdictional in nature, the Court may raise it *sua sponte.*[33] To establish standing:

> First, the plaintiff must have suffered an injury in fact—an invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of—the injury has to be fairly . . . trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court. *Third, it*

[32] Compl. ¶ 54(b).
[33] *Koutoufaris v. Dick*, 604 A.2d 390, 401 (Del. 1992).

> *must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision*.[34]

Plaintiffs' claim for injunctive relief cannot be redressed by a favorable decision. Because Bernard is presently in Chapter 7 liquidation, requiring new disclosures and holding new elections will not remedy any harm that may have resulted from allegedly invalid elections allegedly attributable to inaccurate disclosures; Bernard will remain in liquidation. There can be no right to injunctive relief when all opportunities to avert (or repair) harm to Bernard have long since passed. Had the Plaintiffs brought this action well before Bernard's application for Chapter 7 liquidation, the result might have been different. Unfortunately, they did not, and the Court cannot now address such a request. The Plaintiffs do not have standing to pursue injunctive relief as to their disclosure claims.

Claims for money damages must fail as well. "[T]here is no *per se* rule that would allow damages for all director breaches of the fiduciary duty of disclosure."[35] Damages are limited only to those "that arise logically and directly from the lack of disclosure," and without proving such nexus damages cannot be

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[34] *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) (internal citations and quotations omitted) (emphasis added); *Dover Historical Soc'y v. City of Dover Planning Comm'n*, 838 A.2d 1103, 1111 (Del. 2003) (The Delaware Supreme Court "has recognized that the *Lujan* requirements for establishing standing under Article III to bring an action in federal court are generally the same as the standards for determining standing to bring a case or controversy within the courts of Delaware.").

[35] *Loudon*, 700 A.2d at 146-47.

awarded.[36] The Plaintiffs must plead some reasonable relationship between the alleged disclosure claims and harm suffered individually by the shareholders.[37] They fail to do so here.

Instead, Plaintiffs argue that but for the disclosure violations surrounding the election of the Defendant Directors, the shareholders would have been able to oust those directors and save the Company. In short, it is the Defendant Directors' fault that Bernard is in a Chapter 7 liquidation proceeding. This is not an individually compensable harm because insolvency (or the financial circumstances associated with insolvency) reflects damage to the corporation itself. Although Plaintiffs' disclosure claims to some extent may be direct, unless they show some separate, *individual*, harm those claims are not directly compensable. To hold otherwise would allow Plaintiffs a damage award for the same harm and, presumably, in the same amount, that the Company suffered.[38]

Ultimately, there is no currently viable remedy available to Plaintiffs in their capacity as individual shareholders.[39]

III. CONCLUSION

Despite having drawn all reasonable inferences favoring Plaintiffs from the facts alleged and having also relaxed the applicable pleading standards to account

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[36] *In re Tyson Foods, Inc*., 919 A.2d 563, 602 (Del. Ch. 2007).
[37] *See In Re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d at 773.
[38] *See id.*; *see also Loudon*, 700 A.2d at 135.
[39] *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 360-61 (Del. Ch. 2008).

for Plaintiffs' *pro se* status, the Court is unable to find any allegation of individual injury sufficient to survive a motion to dismiss. Similarly, because of the Bankruptcy proceeding, the Plaintiffs lack standing to pursue the derivative claims.[40]

Accordingly, the Complaint will be dismissed as to all Defendants. The dismissal is with prejudice only as to the named Plaintiffs. An implementing order will be entered.

[40] With these conclusions, it is not necessary to address the other arguments advanced by Defendants. The Court notes that a linear analysis of the issues might have required the Court to consider some of their other arguments before it reached the ones it has found to be dispositive.